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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

By Hand Delivery

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

ORIGINAL

Re: ***Application of Qwest Communications International Inc. To Provide In-Region. InterLATA Services in the States*** *of* ***Colorado, Idaho, Iowa, Montana. Nebraska, North Dakota, Utah, Washington and Wyoming,*** *WC* ***Docket No.*** *02-314.*

Dear Ms. Dortch:

AT&T submits this ***ex parte*** letter and the attached declarations of Douglas Denney, Arthur Menko, Jerry Auriemma and Clark Santos to respond to two erroneous arguments advanced by Qwest in its reply comments. First, Qwest's reply comments contain numerous inaccuracies and misleading statements in an attempt to defend its network operations expense factor, which, as AT&T demonstrated, is based on multiple clear TELRIC errors that inflate Qwest's loop rates by at least **$1.13.** The attached declaration of Douglas Denney addresses these issues. Second, Qwest's reply comments confirm that Qwest's UNE rates in four of the states covered by its Application implement a "price squeeze" that precludes local residential entry. The attached declarations of Arthur Menko, Jerry Auriemma and Clark Santos and the remainder of this letter address these issues.

As demonstrated by AT&T, a properly conducted margin analysis shows that residential local competition is *not* economically feasible in Idaho, Iowa, Montana, or Washington. Qwest's Reply Comments confirm these findings. The margin analyses submitted by Qwest, **like** those submitted by AT&T, show that Qwest's UNE rates provide potential residential entrants with ***negative*** gross margins in at least one UNE rate zone in each of those states.[1] As explained by

[1] **On** Reply, Qwest stands by the margin analyses that it submitted with its first set of section 271 **Applications.** Those analyses show that residential local entrants would earn negative margins in zone **3** in Idaho and Iowa, in zones 3-5 in Washington, and in **as** many **as** all **zones** in Montana. ***See*** Thompson (Qwest I) Decl., **Ex.** 10; Thompson (Qwest II) Decl.. Ex. ***6.***

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the D.C. Circuit, "classic price squeeze cases have never turned on a finding that competition by the input-purchasing firms was absolutely precluded,"' on the contrary, a proper price squeeze inquiry would assess whether "the challenged conduct has exerted *any* anticompetitive effects."[3] Because Qwest concedes that its UNE rates foreclose economically feasible residential competition in at least some parts of Idaho, Iowa, Montana and Washington, there is no question that Qwest's UNE rates effect and unlawful price squeeze that precludes approval of its Application in those states.[4]

The price squeeze in Idaho, Iowa, Montana or Washington is not limited, however, to the UNE zones where gross margins are negative. As demonstrated by AT&T, gross margins must be sufficient to cover an efficient new entrant's internal costs of entry, which exceed $10 in Idaho, Iowa, Montana or Washington.' AT&T further demonstrated that the state-wide gross margins available to new entrants in each of these states falls well below $10. Thus, Qwest's rates preclude state-wide residential UNE-based entry in Idaho, Iowa, Montana or Washington.

Qwest's response to this showing is that the Commission can ignore AT&T's state-wide margin analyses because, according to Qwest, AT&T has provided insufficient evidence to demonstrate that an efficient carrier's internal costs exceed $10. Predictably, however, Qwest does not offer its own analyses of an efficient carriers' internal cost of UNE-based entry. Instead, Qwest relies on its purported costs for resale-only entry. But as the Commission has recognized, a margin analyses must account for a combination of UNE-based and resale costs and revenues.[6]

In any event, to fully respond to Qwest's erroneous claim that AT&T's internal cost analyses are insufficient to establish a competitive carrier's internal costs, AT&T has conducted additional analyses that further support AT&T's initial showing that an efficient local competitor's internal costs exceed $10. Specifically, the attached declaration of Arthur Menko shows that the internal retail costs of RCN (a growing CLEC and internet company), WorldCom, Earthlink (a residential internet business), and cable companies AT&T Broadband, Cox, and Comcast all had internal costs that significantly exceeded $10.[7] In addition, the declaration of Jerry L. Auriemma and P. Clark Santos further supports the reasonableness of the $10 target

[2] Massachusetts 271 Appeal Decision at 8.

[3] *Massachusetts 271 Appeal Decision* at 8 (quoting ***Anaheim*** v. *FERC*, 941 F.2d 1234, 1238 **(D.C.** Cir. 1991) (emphasis added).

[4] A demonstrated by AT&T, the existence of a price squeeze precludes approval of a section 271 application because (I) (1) the price squeeze demonstrates that Qwest's UNE rates in these states are discriminatory in violation of checklist item two and (2) the price squeeze demonstrates that a grant of Qwest's application is not in the public interest. ***See*** AT&T at 78-79.

[5] ***See*** AT&T at 79; ***see also*** AT&T (Qwest I & Qwest 11), Bickley Declarations.

[6] ***See,*** *e.g., Vermont 271* ***Order*** ¶ 69.

[7] *Id.* ¶¶ 65-79.

benchmark by describing in more detail the customer acquisition and customer care costs that AT&T incurs in its local service.

For these reasons, Qwest's response to AT&T's arguments only confirms that Qwest's UNE rates are inflated above TELRIC levels, and that Qwest's Application should be denied.

Respectfully submitted,

/s/ Alan C. Geolot
Alan C. Geolot

Enclosures

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
Qwest Communications International Inc.	)	WC Docket No. 02-314
Consolidated Application for Authority to Provide In-Region, InterLATA Services in Colorado, Idaho, Iowa, Montana, Nebraska, North Dakota, Utah, Washington and Wyoming	)	

SUPPLEMENTAL DECLARATION OF DOUGLAS DENNEY
ON BEHALF OF AT&T CORP.

I. INTRODUCTION AND PURPOSE OF TESTIMONY.

1. My name is Douglas Denney. I am the same Douglas Denney who filed comments with AT&T's initial comments in this proceeding. As I demonstrated in my initial declaration, Qwest's Colorado loop rates are based on a "network operations" factor that is massively overstated, and even exceeds that which Qwest itself proposed in the Colorado UNE rate proceeding. The purpose of my supplemental declaration is to respond to Qwest's meritless response to my initial testimony.'

2. As explained in my initial declaration, the Colorado Public Utilities Commission ("CPUC") correctly recognized that the cost model advanced by AT&T – the HAI 5.2a cost model ("HAI Model") – is capable of producing TELRIC-compliant UNE loop rates Accordingly, the CPUC stated that it would "look primarily to the HAI Model" to set Qwest's

[1] ***See*** Qwest Reply, Thompson/Freeberg Decl. ¶¶ 6-14

Colorado UNE loop rates.[2] However, a model is only as good as the input assumptions used – an appropriately designed forward-looking cost model will not produce forward-looking cost estimates if it is not populated with forward-looking inputs.[3] And many of the key input values approved by the CPUC, often with little or no explanation, were based upon Qwest proposals that violate fundamental TELRIC principles. One of those flawed inputs is a value called "Network Operations Expenses," which estimates the forward-looking costs to manage a local telecommunications network that are not already accounted for on a plant-specific basis.[4]

3. To estimate the amount of Network Operations in a forward-looking network, the HAI model starts with the embedded total expenses from the Qwest ARMIS accounts described above and multiplies them by a forward-looking network operations factor. The developers of the HAI Model have determined that an appropriate forward-looking factor is 50 percent.[5] The forward-looking expenses are then divided by the total lines in the network to develop a per line

[2] ***See*** Colorado Pricing Order at **38.**

[3] See, *e.g.,* Colorado Pricing Order at 40 (recognizing that "input assumptions constitute the main difference in the results of the cost models").

[4] Network operations expenses include costs for (1) provisioning; (2) power; (3) Network Administration; (4) Testing; ***(5)*** Plant Operations Administration; and ***(6)*** Engineering. See Denney Decl. ¶ ***5.***

[5] The 50 percent factor is based on several considerations. As a preliminary matter, it is necessary to adjust Qwest's embedded Network Operations costs to account for efficiencies that arise on a forward-going basis, *e.g.,* between 2000 and 2001 alone Qwest's Total Network Operations expenses have fallen by 10.6 percent. It also is necessary to adjust Qwest's reported embedded Network Operations expenses downward to ensure that those costs reflect TELRIC principles, because Qwest's Network Operations accounts include many items that are not TELRIC costs. First, some of the accounts in Qwest's reported network operations include costs that are specific to retail operations and would be performed by those who buy UNEs rather than the incumbent LEC that sells these UNEs. Second, many of the administrative and engineering functions included in the Network Operations accounts are already recovered by Qwest through non-recurring charges. Third, many of the costs reported in Qwest's Network Operations accounts are already at least partially recovered in other recurring rate elements. ***See*** Denney Decl. ¶¶ **7-8.**

expense. This per line expense is allocated to the loop by adding it to the loop related portion of the total loop-specific direct expense estimate.

4. The problem with the UNE loop rates adopted by the CPUC is that, in developing those rates, the CPUC erroneously applied a forward-looking factor of *96 percent* – almost double the forward-looking factor used by the Model's developers. The reason why the Commission was persuaded to adopt the 96 percent network operations factor is because Qwest informed the CPUC that Qwest itself used a similarly high network operations factor in its cost study. **As** explained by the CPUC, "[t]he network operations expenses as used in the Qwest model are acceptable." ***577T*** at 62.

5. However, as I showed in my initial declaration, Qwest's cost study does ***not*** rely on a cost factor that is even close to 96 percent. On the contrary, Qwest's cost study relies **on** a cost factor that is closer to the 50 percent value that should be used in the HAI Model. Indeed, the network operations cost factor that is actually used by Qwest's cost study results in Colorado loop rates that are **51.13** lower than those adopted by the CPUC.[6]

6. On reply, Qwest claims that my analysis is wrong. Tellingly, however, Qwest does not deny or provide any evidence to contradict my showing that the effective network operations factor used by Qwest's cost studies is near 50 percent. Instead, Qwest's witnesses advance a series of baseless and irrelevant attacks on my testimony.

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[6] See Denney Decl. ¶ 11

II. QWEST CLAIM THAT THE COMMISSION SHOULD IGNORE NETWORK OPERATIONS FACTORS AND FOCUS INSTEAD ON *TOTAL* EXPENSE FACTORS IS A RED HERRING.

7. As I demonshated in my initial testimony, the 96 percent network expense factor adopted by the CPUC is far higher than that used by the supporters of the HAI model and that used in Qwest's cost model. If the CPUC had actually implemented the network operations expense factor effectively used in Qwest's cost studies – which it purported to do – Qwest's Colorado loop rate would be $1.13 lower than the current rate. As noted, Qwest does not deny this fact.

8. Instead, Qwest claims that the Commission can ignore that the CPUC adopted a network operations factor that is higher than that used in Qwest's own cost studies because the CPUC also adopted some other **non-network-operations-related** expense factors that are lower than those in Qwest's cost study.[7] But Qwest misses the point. Each expense factor in the HAI Model is designed to recover the costs of different expenses. The network operations expense input is designed to recover the costs of network operations expenses, and that factor can (and should) be computed independently from the other expense factors, which are designed to recover the costs for other activities in Qwest's network. Accordingly, the level of non-network operations expenses adopted by the CPUC are not relevant to assessing whether the ***network operations*** expenses adopted by the CPUC are TELRIC-compliant. In fact, it is precisely for this reason that the CPUC properly addressed the level for the network operations factor ***independently*** of Qwest's other expense factors.

[7] ***See*** Thompson Freeberg Decl. ¶ 9.

9. Qwest's argument that the Commission can ignore the overstated network operations expense input adopted by the CPUC also is flawed for another reason. By Qwest's logic, the overstated network operations expenses are justified because the CPUC adopted *total* expenses that are lower than those initially proposed by Qwest. That argument, however, is based on the unproven premise that the reductions to Qwest's proposed non-network operations expenses are below TELRIC levels, and that those below-TELRIC non-network expense factors offset the massive overstatement in the network expense input. Qwest however offers *no evidence* that the non-network operations expenses are below TELRIC levels, let alone that those other expense factors are sufficiently low to offset the massive rate inflation caused by the overstated network operations expense factor.

III. QWEST'S CLAIM THAT THE NETWORK OPERATIONS EXPENSES IN ITS COST MODEL CANNOT BE COMPARED TO THAT IN THE HAI MODEL IS NOT TRUE.

10. As I explained in my initial testimony, Qwest proposed that the CPUC adopt a 100 percent network operations factor for use in the HAI Model even though Qwest's cost model relies on a network operations factor that is closer to 50 percent. According to Qwest, however, a valid comparison cannot be made between the expenses in the HAI Model and those in Qwest's cost studies.' That claim is pure fiction, and is belied by Qwest's own witnesses' testimony. In footnote 14 of the declaration submitted by Qwest witnesses, Mssrs. Thomson and Freeberg, make exactly such a comparison – an amazing feat given Qwest's claims that such comparisons are not possible

[8] See Thompson/Freeberg Decl. ¶ 9 ("AT&T's argument . . . improperly mixes and matches the network operations factor used in Qwest's TERLIC loop cost model with the supposedly corresponding input in the entirely different HAI model.").

11. The truth is that the HAI Model and Qwest's cost study account for network operations expenses differently. The HAI Model computes a dollar amount for network operations expenses that is added to the loop rate, whereas the Qwest cost study uses factors that gross up the various loop related costs to account for network operations expenses. However, as I demonstrated in my initial testimony it is a straightforward procedure to apply Qwest's network operations expense factor to the loop elements to determine the dollar increase in the loop rate caused by applying Qwest's network operations factor. (My initial testimony fully documents exactly how that computation is done. Tellingly, Qwest barely even attacks? or even addresses, those computations.) The dollar figures computed from Qwest's cost studies can then be directly compared to the dollar figures used in the HAI Model.

IV. QWEST'S ASSERTION THAT QWEST'S COST REDUCTIONS BETWEEN 2000 AND 2001 ARE IRRELEVANT MUST BE REJECTED.

12. During the Colorado pricing proceeding, Qwest claimed that the network operations expense factor should be based on Qwest's embedded costs as of year 2000. According to Qwest, "Qwest's network operations expenses in Colorado declined between 1995 and 1997," those costs "have remained steady since then," and "[b]ecause the HAI Model starts with 2000 data it already accounts for cost reductions since 1995."[10] Based in part on Qwest's assertions, the CPUC did not account for the declining cost trend in Qwest's network operations expenses

[9] Qwest only questions whether it was appropriate to account for the 23.6% reduction in the loop rates proposed by Qwest. **As** I demonstrated in my initial testimony (¶ 10 n.8), that reduction was appropriate, and must be accounted for to properly compute Qwest's network operations expense factor.

[10] ***577T Order*** at 62

13. Predictably, Qwest's promise to the CPUC that its network operations expenses would not continue to decline after 2000 was false. As I demonstrated in my initial testimony, Qwest's network operations costs continued their downward trend (another 10.6% reduction) between 2000 and 2001, and Qwest has provided no evidence to contradict this fact. In this regard, the CPUC relied on false information when it adopted a network operations expense factor that does not reflect the trend in Qwest's cost studies. Thus, Qwest's assertion that this Commission should ignore that fact" when assessing whether the network operations costs adopted by the CPUC are TELRIC-compliant must be rejected.

14. The bottom line is that the CPUC refused to account for the downward trend in network operation expenses based on Qwest's false promise that its embedded 2000 network operations expenses reflected all previous cost reductions, and that those reductions were not likely to continue on a forward-going basis.[12] CPUC's determination was clearly an error. And the extent of that error is now apparent – Qwest's network operations costs have in fact declined by 10.6 percent between 2000 and 2001. Thus, in my view it is appropriate to account for this fact in assessing whether Qwest's network operations factor is TELRIC-compliant.

V. CONTRARY TO QWEST'S CLAIMS, AT&T HAS NOT WAIVED ITS CLAIM THAT QWEST'S NETWORK OPERATIONS FACTOR IS SUBSTANTIALLY OVERSTATED.

15. Qwest asserts that AT&T has "waived" any claim that Qwest's Colorado rates are based on an overstated network operations factor, because AT&T did not adequately raise this issue before the CPUC. According to Qwest, the Commission should completely ignore the

[11] Thompson/Freeberg Decl. ¶ 13.

[12] Rebuttal and Cross Answer Testimony of William L. Fitzsimmons, at 44 (July 20, 2002); Rebuttal Testmony of D.M. Gude, at 17 (July 20, 2001).

clear TELRIC errors that substantially inflate Qwest's network operations expenses on the grounds that the CPUC never had an opportunity to assess whether the network operations factor used in Qwest's cost study is comparable to that ultimately adopted by the CPUC. That claim is dead wrong – indeed, the CPUC did ***explicitly*** considered the network operations factor in Qwest's cost study in making its determinations.[13]

16. Even if (contrary to fact) the CPUC did not have ample opportunity to address the network operations factor used in Qwest's model, it is my understanding that AT&T still has not waived its right to raise that issue in this proceeding, because AT&T also attacked Qwest's proposed network aperations factor in the Colorado pricing proceeding on myriad alternative grounds. In fact, AT&T filed numerous pages of testimony demonstrating that a proper network operations factor in the HAI Model should be 50 percent, which the CPUC erroneously rejected. That evidence included a showing that Qwest's embedded network operations expenses should be substantially discounted to account for the facts that (1) some of the accounts in Qwest's reported network operations include costs that are specific to ***retail*** operations and would be performed by those who buy UNEs rather than the incumbent LEC that sells these UNEs; **(2)** many of the administrative and engineering functions included in the network operations accounts are already recovered by Qwest through non-recurring charges; and **(3)** many of the costs reported in Qwest's Network Operations accounts are already at least partially recovered in recurring rate elements. As noted, AT&T also demonstrated that Qwest's embedded year 2000 network operations expenses should be adjusted downward based on the historical downward

[13] ***See*** *577T* at 62 (noting that it was relying on the "network operations expenses as ***used in the Qwest model"). As*** noted, even though the CPUC attempted to adopt the network operations factor used in Qwest's model, the CPUC erroneously adopted a network operations factor that is nearly two-times that used by Qwest's model.

trend in Qwest's network operations expenses. Thus, the CPUC had ample opportunity to address the argument that the network operations expense factor should be closer to 50 percent than to 100 percent.

17. On this record, there is no legitimate basis for Qwest's assertions that AT&T has not provided the CPUC sufficient opportunity to address these arguments. Thus, based on my understanding **of** the Commission's procedures, this evidence is appropriately considered as part of Qwest's section 271 application.

CONCLUSION

18. For the foregoing reasons, and the reasons stated in my initial declaration, Qwest's loop rates are inflated by a clear TELRIC error. To correct for that error, Qwest's loop rate should be reduced by $1.13.

VERIFICATION PAGE

I declare under penalty of perjury that the foregoing Declaration is true and correct

/s/ Douglas Denney

Douglas Denney

Executed on: November 7,2002

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
Application by)
Qwest Communications International, Inc.) WC Docket No. 02-314
For Authorization To Provide)
In-Region, InterLATA Services in the)
States of Colorado, Idaho, Iowa, Montana,)
Nebraska, North Dakota, Utah,
Washington, and Wyoming

DECLARATION OF ARTHUR S. MENKO
ON BEHALF OF AT&T CORP.

I. BACKGROUND

1. My name is Arthur S. Menko. My business address is 63 West Lancaster Avenue, Ardmore, Pa. 19003. I am the president of Business Planning, Inc. ("BPI"), a consulting firm that performs benchmarking analyses, survey and database services, financial analysis, service reliability assessment, market planning and other performance metrics for the telecommunications industry. Prior to founding BPI, I served as a Senior Economist at Chase Econometrics in Bala Cynwyd, Pennsylvania from 1983 to 1984 and as a Forecast Manager at New York Telephone from 1978 to 1983. I received my B.A. in Economics from Lehigh University and my M.B.A. in Economics and Finance from New York University in 1978.

II. SUMMARY OF TESTIMONY

2. My testimony supports the reasonableness of the estimates of AT&T's internal retail costs of more than $10 per month as set forth in AT&T's Declarations of Steve

Bickley submitted in connection with Qwest's Section 271 filings[1] These internal retail costs include a carrier's sales and marketing, customer care, billing and collection, uncollectible expense, and general and administrative costs. The reasonableness of the Bickley internal retail cost figures is confirmed by data on the customer acquisition, customer care and general administrative costs incurred by other telephone and cable carriers. RCN, a growing CLEC and internet company serving predominantly the residential communications market, has internal retail costs per customer connection[2] of approximately $15.81 per month for 2001. Similarly, Earthlink is in the highly competitive residential internet service business and has incurred retail costs of at least $1 1.43 per month for 2001; adding customer care and technical support costs of approximately *$6* per month further increases **Earthlink's** monthly cost per connection above the **$10** "target benchmark" set forth in the Bickley Declarations. Additionally, cable providers AT&T Broadband, Cox, and Comcast offer services in competitive cable, internet, cable telephony, and broadband markets and have experienced internal sales, general and administrative expenses ("SG&A Expenses") that have ranged from **$13.36-$14.18** per month per connection in 2001; on a per basic subscriber basis, the SG&A figures for the cable companies are even higher at **$15.27-$20.37** per month. These real-world costs from companies

[1] See Declaration of Steve Bickley on Behalf of AT&T Cop, *In the Matter of Qwest Communications International Inc. Consolidated Application for Authority lo Provide In-Region InterLATA Services in Colorado. Idaho, Iowa, Nebraska and North Dakota*, Docket No. 02-148 (July 3, 2002) (discussing. *inler alia,* Idaho and Iowa) ("Bickley Dec. Qwest I"); Declaration of Steve Bickley on Behalf of AT&T Corp., *In the Matter of Qwest Communications International Inc. Consolidated Application for Authority to Provide In-Region InterLATA Services in Montana, Utah, Washington, and Wyoming,* Docket No. 02-189 (Aug. 1, 2002) (discussing, *inter alia,* Montana and Washington) ("Bickley Dec. Qwest II"). These two declarations shall be referred to collectively as the "Bickley Declarations."

[2] RCN offers several telecommunications, cable, and Internet services, each one of which is treated as a separate connection. Thus, a customer taking both telephone and Internet service represents two connections for purposes of computing per connection costs even though the company may achieve efficiencies, for example, by issuing a single bill to the customer covering all that customer's services. Use of this approach produces a conservative (i.e., lower) estimate of internal retail costs. Similarly, my analysis of cable companies also reflects conservative assumptions because it is also based on total connections (i.e., one subscriber may be both a basic cable subscriber and a cable modem subscriber). I have also provided the cable company data on a per subscriber basis.

in competitive communications markets demonstrate that, as shown by the Bickley Declarations, efficient CLECs currently incur more than **$10** per month of internal retail costs, and that $10 represents a very conservative "target benchmark" for AT&T as an efficient CLEC seeking to win and retain customers in the competitive local exchange market.

III. THE ROLE OF INTERNAL RETAIL COSTS IN THE PROVISION OF RESIDENTIAL TELECOMMUNICATIONS SERVICE.

3. AT&T has included a margin analysis showing that Qwest's inflated UNE rates foreclose potential residential UNE-P or resale entry in Idaho, Iowa, Montana, and Washington. ***See** generally* Lieberman/Pitkin Decl. In support of that claim, AT&T has submitted the Bickley Declarations, which estimate that AT&T incurs in excess of $10 per month in internal retail costs to provide residential UNE-P service. Bickley Dec. Qwest **I,** ¶ 2; Bickley Dec. Qwest II, ¶ 2. This above-$10 figure does not include development costs, interconnection costs with Qwest's **OSS systems,** or systems readiness testing but does **take** into account productivity improvements anticipated in the future. *Id.* Moreover, the above-$10 internal retail cost is not currently achieved by AT&T but represents a "target benchmark" of the best that a competitive carrier such as AT&T could achieve with efficiencies and economies in a competitive environment. ***Id.***

4. The Bickley Declarations separate the internal retail costs into five separate "buckets" associated with retail residential service:

- marketing and sales costs – costs of customer acquisition through promotions, telemarketing, other marketing channel costs, and ordering and provisioning;
- customer care costs --the costs of answering questions from customers about their service, providing trouble support when customers report service problems, and performing account maintenance functions;

- billing and collection costs --the costs of collecting and collating customer billing information, sending out bills, following up with customers who do not pay, and collection activities;
- costs for uncollectibles -- costs representing amounts for services rendered that are not paid by customers; and
- other general and administrative costs --incremental product and market management, systems maintenance costs, and other network related expenses associated with a local marketplace **offer.**

5. The proprietary versions of the Bickley Declarations include estimates of each of these AT&T internal retail cost categories that, in total, exceed $10 per month. Bickley Dec. Qwest **I, ¶¶ 5-18** (Idaho, Iowa); Bickley Dec. **Qwest** II, ¶¶ 5-11, **19-24** (Montana, Washington)

IV. OTHER COMMUNICATIONS COMPANIES HAVE INTERNAL RETAIL COSTS THAT REFLECT SIGNIFICANT CUSTOMER ACQUISITION AND CUSTOMER CARE EXPENSES.

6. The reasonable nature **ofthe** costs included in the Bickley Declarations is demonstrated by the similar or **greater** internal retail costs incurred by other companies operating in competitive telecommunications markets. CLECs **are** similar to companies in the internet, cable, and broadband markets in that they are seeking to gain **new** customers in competitive markets and must devote substantial **resources** to customer acquisition and customer we. Customer acquisition expenses **are** incurred to identify potential customers, interest those customers in the company's services, and then win the customer's business. The customer acquisition costs are largely sales and marketing expenses to educate consumers and provide incentives for customers to leave their existing provider or to use a new service.

7. To win and retain customers, CLECs and these communications companies must also provide potential and new customers with a seamless ordering and an

efficient customer interface that requires a significant investment in systems and well-trained personnel to handle service and billing inquiries. Customer care costs are high because customers are new and unfamiliar with the new services provided by CLECs and communications companies and often have questions about the service offerings, billing formats, and bills. The companies must be in a position to handle such inquiries quickly and efficiently or risk losing the new customer. As a result, CLECs and communications companies must devote substantial resources to customer care expenses.

8. The publicly available 2001 data on RCN, Earthlink, and leading cable companies (AT&T Broadband, Cox, and Comcast) demonstrate that they incur many of the same types of internal retail costs as CLECs and that their costs are similar to or exceed the $10 "target benchmark" set forth in the Bickley Declarations. Similarly, the evidence submitted by WorldCom in other Section 271 proceedings estimates that its internal costs per customer are greater than $10 per month. The data from these various companies reflect different business strategies and cost structures and do not correspond directly to the categories set forth in the Bickley Declarations, but the businesses of these CLECs and other companies as providers of services to residential customers in competitive communications markets make them appropriate cost analogs in drawing conclusions about the level of internal retail costs incurred by efficient providers in the competitive residential local service telecommunications markets.

A. RCN

9. RCN is a CLEC that is the nation's first and largest residential facilities based competitive provider of bundled telephone, cable, and high-speed internet services to the most densely residentially populated markets in the United States. It is a public company that has been operating in a challenging marketing and financial environment, but has been steadily

bringing new customers onto its own network and incurring significant customer marketing costs to increase public awareness its various service offerings. It has also built an infrastructure to handle customer care issues.

10. Using publicly available information,[3] I have attached to this declaration as Attachment 1 a table of financial and operating information listing 2001 RCN expenses. Based on that information, I have prepared a chart that lists the monthly costs per connection for RCN's services. I have included all RCN's telephone, cable, and internet services that are both on and off its network,[4] as combining all RCN's various services spreads the customer care, marketing and administrative costs among all the services and produces the lowest cost estimates. I have also treated each separate service offering for a customer as a separate "connection," or revenue generating unit. Thus, a customer who uses RCN's cable service and telephone service is treated as two separate "connections." This treatment spreads the internal retail costs among the broadest number of customer connections and yields the lowest monthly cost. Because not all general and administrative costs relate to internal retail costs, I have allocated those general and administrative costs based on a ratio of sales and marketing expenses to the total costs of goods sold.[5]

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[3] These documents include 2001 RCN Annual Reports, 10K filings with the SEC, and quarterly investor relations reports.

[4] Off the network services includes resold phone connections and dial-up ISP customers. On the network services include cable, high speed data services, and phone connections over RCN's facilities.

[5] As noted in the text, I have taken the percentage of sales and marketing costs to the total cost of goods sold to determine the appropriate percentage of general and administrative costs that relate to sales and marketing Sales and marketing represent 33% of the total costs of goods sold in 2001, and I have applied that percentage to the total 2001 general and administrative costs in determining internal retail costs as set forth in the chart.

2001 RCN Monthly Costs per Connection

Cost of Providing Services	$ 14.66
Installation and Provisioning	$ 7.75
Operating Selling and Gen. & Admin	
Customer Services and Order Processing	$ 5.14
Advertising, Sales and Marketing	$ 5.70
Allocated General & Admin.	$ 4.97
Total Internal Retail Cost	$ 15.81

11. In the chart, the total Operating Selling and General Administration costs consist of three categories. Customer Services and Order Processing costs represent the cost of customer service representatives, customer care, and billing and collection. Advertising, Sales and Marketing costs represent the cost of advertising, telemarketing, marketing staff expense, and commissions paid to gain customers and/or acquire additional connections per home (i.e., additional connections per household). General and administrative costs represent support staff, information technology systems, other administrative support, start-up regulatory costs, new product development, uncollectibles, and damages and settlements.

12. The chart shows RCN's 2001 internal retail costs of $15.81 per month. This figure gives an indication of the significant internal retail costs that communications companies incur to attract and retain customers. Advertising, Sales and Marketing expenses are a rough proxy for RCN's customer acquisition costs, and RCN spent $5.70 per month in 2001 to acquire new customers and expand service offerings to these customers. This level of spending is a sizable cost and reflects the importance of raising customer awareness of RCN's service offerings

13. The Customer Services and Order Processing costs are a combination of the Customer Care and Billing and Collection costs as defined in the Bickley Declarations, and

these amounts also represent a significant monthly expenditure for RCN of $5.14 per month. The General and Administrative costs represent that portion of the total general and administrative expenses that relate to sales and marketing and have averaged $4.97 per month for RCN.

14. RCN's total 2001 internal retail costs of $15.81 per month illustrate the high level of expenditures that second or alternative providers must spend to gain and retain customers. Given this levels of costs, the "target benchmark" of $10 per month in the Bickley Declarations represents a reasonable (indeed, understated) level of internal retail costs.[6]

B. Earthlink

15. Earthlink is an internet service provider ("ISP") that offers narrowband and broadband internet/email service predominantly to the residential market. The ISP market is intensely competitive, and Earthlink must accordingly make substantial expenditures to market its services and provide superior customer service.

16. Attachment 2 lists relevant publicly available 2001 financial information relating to Earthlink. This financial information serves as the basis for the chart below listing Earthlink's financial data presented on a monthly per connection basis. Earthlink has added customers through acquisition of other companies and by sales and marketing efforts including advertising, direct mail, promotional material, sales compensation, bonuses, salaries, and various incentives including trial subscriptions. The line "Acquisition Costs" in the chart below

[6] Another CLEC, WorldCom, presented evidence in Section 271 proceedings stating that its internal retail costs exceed $10 per month. In the New Jersey Section 271 proceeding, Vijetha Huffman of WorldCom submitted a declaration in which she stated that WorldCom incurs internal retail costs in excess of $10 per month per subscriber for its UNE-P service, excluding up-front development costs. Declaration of Vijetha Huffman, WorldCom, *In the*

(Footnote continued)

represents the amortized cost to Earthlink of its acquisition of OneMain.com, Netcom, and a number of other smaller ISPs. Earthlink's general and administrative expenses are presented as a single cost item and are allocated **to** internal retail cost based on the ratio of sales and marketing costs to the total cost of goods sold.

Sales/Marketing	**$6.92**
+ Acquisition Costs	**$3.80**
Allocated G&A	**$0.71**
Retail Costs	**$ 11.43**
+ Operations / Member Support	**$ 5.94**
Internal Retail Costs and Operations Cost	$ **17.37**

17. This chart demonstrates that Earthlink's internal retail costs are significantly higher than the $10 "target benchmark" **figure** stated in the Bickley Declarations. Retail Costs plus customer information systems, customer/technical member support and operations produce an average monthly cost of **$17.37 for 2001.** Indeed, Earthlink's **2001** customer acquisition costs alone -- representing the **sum of** its sales and marketing costs and its acquisition costs -- **were $10.72** per month.

C. Communications Cable Companies

18. A third set of data points supporting the reasonableness of the **figures** in the Bickley Declarations are the SG&A Expense of various communications companies providing cable, broadband, telephone, and Internet services. I have reviewed publicly available data on AT&T Broadband (formerly TCI and Media One), Cox Communications, and Comcast

Matter of Application of Verizon New Jersey, Inc., for Authorization to Provide In-Region, InterLATA Services **in** *New Jersey*, *CC* Docket **No.** 01-347 (**filed January 14,2002).**

to develop estimates of SG&A Expense for these three companies.[7] Attachment 3 lists the financial and operational data that serve as the basis for this chart

2001 Cable SG&A Expense per Month per Connection

Company	
AT&T Broadband	$13.36
Cox	$14.18
Comcast	$13.74

19. The 2001 SG&A Expense is not directly equivalent to internal retail costs and includes general and administrative expenses that are not allocable to retail costs. I do not have the information to allocate general and administrative costs as I did with RCN and Earthlink, and therefore at one level these numbers are not directly comparable with the internal retail cost figures provided for RCN and Earthlink. They are a useful data point, however, in that they reflect the large subscriber base enjoyed by the cable companies, and demonstrate the significant expenditures that must be made by companies in competitive markets for sales, marketing and customer acquisition and servicing. Moreover, consistent with my approach with RCN, these figures include each service offering taken by a customer as a separate "connection" for purposes of computing the SG&A Expense on a per monthly basis. Thus, the per month figures would be higher if computations were based on basic subscriber counts instead of "connections."

2001 Cable SG&A Expense per Month per Basic Subscriber

Company	
AT&T Broadband	$15.82
Cox	$20.37
Comcast	$15.27

[7] AT&T Broadband data are from the AT&T and Comcast Joint Proxy Statement and Prospectus dated May 14, 2002; Cox data are from Cox's 2001 Investor Relations Reports and profit and loss pro forma and operating statistics from Cox's website and from Cox's 2001 Annual Reports and Form 10-K Reports. In the AT&T and Comcast Joint Proxy Statement and Prospectus dated May 14,2002, Comcast provided its 2001 SG&A Expense

20. In 2001, the SG&A Expense per basic subscriber (Cable TV subscribers, which better approximates actual subscriber counts) were $15.82 per month for AT&T Broadband, $20.37 per month for Cox, and $15.27 for Comcast. These expenses represent significant expenditures as cable companies seek to expand their service offerings and increase their customer base in the growing markets of broadband, internet service, and cable telephony.

V. CONCLUSION

21. The reasonableness of the costs in the Bickley Declarations is supported by data from the CLECs RCN and WorldCom, the internet service provider Earthlink, and cable companies showing that their internal retail costs match or exceed the costs in the Bickley Declarations. Accordingly, the internal retail costs set forth in **the** Bickley Declarations **are the** costs **of** an efficient competitor.

VERIFICATION

I declare under penalty of perjury that the facts stated herein are true and correct, to the best of my knowledge, information and belief

/s/ Arthur S. Menko
Arthur S. Menko

Date: November 8, 2002